The MAGAZINE of WALL STREET

Richard D. Wyckoff

What Every Business Man Wants to Know

An Interview on the Business Outlook with

SENATOR-ELECT EDWARDS

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In The

Nine Strongest Industries

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Livermore's Methods Analyzed

8. How He Tests the Market

By RICHARD D. WYCKOFF

IN discussing Mr. Livermore's operations with a friend one day, the subject turned to his practice of testing the market for various stocks at certain times in order to ascertain the correctness of his position. My friend claimed that much of his success was due to the fact that Livermore is now sufficiently supplied with working capital to enable him to test out the market for different stocks in which he is trading. My contention was that while testing operations have their value, the market is constantly undergoing a series of tests; that these tests which are observable on the tape at almost every moment during the five-hour Stock Exchange session, are far more important than any individual tests applied to a comparatively few stocks.

Testing a Market

For the benefit of those who do not understand how a market is tested, I will say that when a large operator takes on a line of stock he keeps a constant check as to the attitude of the pools, the individual operators, and the public operating in that issue, his main object being to stay with the stock so long as the technical position favors his commitment, and the moment there is a change in this respect he will very often lighten his load or get out of it altogether.

The principal elements in market manipulation are support and pressure. Support means not only the price which is bid for a stock, but the amount which is bid for. Mr. Livermore, like any other large operator, when he takes on a line of long stock, usually does so because he sees accumulation. If, therefore, he sees accumulation at a certain level and he buys part or all of his line, it is important for him to know whether any of these other factors are supplying him; whether the stock is easy or difficult to buy; whether there is a good market there on which to sell if he should change his mind as to the prospects; whether the buying is in large lots or small lots, and other indications which aid him in forming a conclusion.

Suppose he has bought 5,000 shares of a certain stock at 60 and he has in mind increasing his line to 10,000 or 15,000 shares if it continues to look good to him, and he sees nothing to interrupt its advance to a level which will give him his minimum anticipated profit or possibly more. The stock may get up around 63 and the character of the market in it may begin to change; that is, he may observe on the tape and in his reports from the floor that the supply at that level is larger than the demand. He may wish to test out this demand for he knows that so long as nothing has occurred to interrupt the move, the pool or group of interests that are the chief factors in the rise will be willing to buy stock, although they may try to make it look weak in order to induce liquidation or short selling. He thereupon sends his brokers into the crowd to sell 2,000 or 3,000 shares in order to see how they take it. If the pool is ready and willing to take it and he is able to dispose of the entire lot at a mere fraction under the previous sale, he is encouraged to hold the balance, replace what he sold and take on an additional lot, for he has definite evidence that the pool would rather buy than sell and he wants to go with it—along the line of least resistance.

Assuming a Neutral Position

But, if he should find that in the sale of these 2,000 or 3,000 shares, he depresses the market a point or two, he is likely to close out the balance and assume a neutral position in that stock on the ground that his judgment was wrong and the pool was not ready or willing either to support the price or to mark it up further.

He may keep the stock under observation for a considerable period and wait for very definite evidence that the pool is ready to begin the marking up process, which is what might be called the middle section of the manipulation, the first being accumulation, the second marking up, and the third distribution.

If he should suspect that the pool is changing its plans and endeavoring to liquidate its long position or to establish a short position, he is likely to await some of its strenuous attempts to distribute and then help things along by passing out a little for his own short account. The stock might during this process be marked up from around 63 to, say, 68, and between that level and 65 it might be juggled back and forth to attract both kinds of buyers: those who purchase on strong spots, and those who buy only on reactions. Somewhere in that area he will make up his mind that the pool is unloading and he will therefore take a short position; and when the pool has completed the undertaking and begins to lower the bid price, he will render further assistance by supplying a few thousand shares more of short stock. His testing operations in such a case might be to buy a few thousand shares in order to make sure that the pool is supplying bids for round amounts, and if so he will close out his test purchases and sell more.

In all these operations he has formed an opinion of what is likely to happen, and in taking a position he does it tentatively because he never knows in advance when he is likely to be wrong or when some sudden development or change in the character of the market or an alteration in the plans of the pool will cause him to follow this new lead. He sticks to his trades so long as he has no reason to change his original opinion, and when he thinks he is wrong he gets out.

The ordinary testing to which I refer and to which the market is constantly subjected is evidenced by momentary changes in the technical position. These plus and minus signs which you see in the newspapers at the end of the day's session are the net results of thousands of little movements taking place in various stocks and may be regarded as the concrete expression of the theoretical composite man, expressing the mind of all the millions of traders and investors who deal in stocks. These Mr. Livermore interprets in two ways: (1) the course and the action of the market as a whole; and (2) the same thing in respect to individual stocks. The numerous primary moves, with their rallies and reactions expressed in their action or behavior under certain conditions of relative strength or weakness, are the most satisfactory tests after all, for the tape presents them constantly. They require no market commitments and no expenditure of money, but the correct interpretation of these market phases is something which requires a long and sustained effort over a period of years, combined with many thousands of attempts to extract profit from the fluctuations, all of which go to make up what is known as the trading character of an operator.

It is in these respects that Mr. Livermore qualifies and it is out of these experiences that he has developed the judgment which, while not infallible, is possessed of a high percentage of accuracy.

(*To be continued in an early issue*)

Intimate Talks With Readers

How High and How Low?

A TRADER was about to put in an order to sell his Studebaker (then around 135) at 150 G. T. C., his explanation being—on a burst of strength—that "it looked like 150." We said, "Young man, there is one sure thing about your hunch. You can guess exactly the possible bottom of Studebaker, which is 0; but no stock has a possible top within reason."

The fault here was the guesswork being employed. The burst of strength might be due to anything. An hour later there might be every reason in the world for selling it; and conversely, at 150 it might be a better "buy" than ever. We casually drew attention to what happened in Bethlehem Steel and General Motors (old stock) at those figures; and while

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